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**VIA ELECTRONIC FILING**

The Honorable Comer H. "Randy" Randall, Chairman  
Public Service Commission of South Carolina  
101 Executive Center Drive  
Columbia, South Carolina 29210

Re: Procedure to Address Conceptual Issues Around Non-Allowable Expenses (See  
Page Number 4 of Order No. 2019-341), Docket No. 2019-232-A

Dear Chairman Randall:

Thank you for the opportunity you have provided to Dominion Energy South Carolina, Inc. ("DESC") to offer comments concerning certain expense disallowances in rate proceedings. These issues arise from Docket Nos. 2018-318-E and 2018-319-E. Inasmuch as DESC was not a party to that docket, we are not aware of all the details related to the matters in dispute. However, many of the issues involved in that docket are analogous to issues that have arisen between DESC and the South Carolina Office of Regulatory Staff ("ORS") in past proceedings. DESC will comment from that perspective.

**1. BACKGROUND AND STATUTORY STANDARDS**

The overarching legal standard for utility rates is that they must be "just and reasonable." S.C. Code Ann. § 58-27-810. This standard incorporates the rule that unjust or insufficient rates constitute an unconstitutional taking of private property for public use without just compensation in violation of the Takings Clause of the United States and South Carolina Constitutions. U.S. Const. amend. V; S.C. Const. art. I, § 13(A). "If the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments." *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308 (1989); *accord, S. Bell Telephone & Telegraph Co. v. S.C. Pub. Serv. Comm'n*, 270 S.C. 590, 595-96, 244 S.E.2d 278, 281 (1978).

In the seminal case of *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), the United States Supreme Court recognized the inherent link between expenses and compensatory returns: In setting a just and reasonable rate "it is important that there be enough revenue *not only for operating expenses* but also for the capital costs of the business." *Hope*, 320 U.S. at 603

(emphasis supplied). The failure to acknowledge a significant known and measurable expense item, even one occurring after the close of the test period, is reversible error. *Daufuskie Island Util. Co., Inc. v. S.C. Office of Regulatory Staff*, 420 S.C. 305, 318–19, 803 S.E.2d 280, 287 (2017).

As a procedural matter, duly recorded utility expenses are deemed prudent in ratemaking proceedings but subject to challenge. *Hamm v. S.C. Pub. Serv. Comm’n*, 309 S.C. 282, 286, 422 S.E.2d 110, 112 (1992).

Although the burden of proof of the reasonableness of all costs incurred which enter into a rate increase request rests with the utility, the utility’s expenses are presumed to be reasonable and incurred in good faith. This presumption does not shift the burden of persuasion but shifts the burden of production onto the Commission or other contesting party to demonstrate a tenable basis for raising the specter of imprudence.

*Hamm*, 309 S.C. at 286, 422 S.E.2d at 112 (citations omitted). Thus, the party challenging utility costs must present evidence “raising the specter” that the expenses are imprudent. *Id.* The Commission is then obligated to provide a full opportunity for the utility to demonstrate that the expenses, like other aspects of a rate request, are reasonable and justified. *See Utilities Servs. of S.C., Inc. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 107, 708 S.E.2d 755, 761 (2011). “In scrutinizing evidence during a ratemaking proceeding, the commission should evaluate the evidence in accordance with objective and consistent standards.” *Daufuskie Island Util. Co., Inc. v. S.C. Office of Regulatory Staff*, No. 2018-001107, 2019 WL 3310477, at \*3 (S.C. July 24, 2019).

In evaluating expenses, it is not enough to determine that similar expenses have been disallowed in the past. “The declaration of an existing practice may not be substituted for an evaluation of the evidence. A previously adopted policy may not furnish the sole basis for the Commission’s action.” *Hamm*, 309 S.C. at 289, 422 S.E.2d at 114 (citations omitted.).

## 2. ACCOUNTING PRACTICES AND THE SEGREGATION OF ALLOWABLE FROM NON-ALLOWABLE EXPENSES

As mandated by federal law, DESC maintains its expense ledgers according to the Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act (“FERC Chart of Accounts”), 18 CFR Part 101. The FERC Chart of Accounts segregates expenses into “above-the-line” and “below-the-line” amounts. Below-the-line amounts are specifically removed from rate-making and are in essence “non-allowable” expenses. Conversely, above-the-line amounts are meant to be “allowable” expenses for rate-making

The principal categories for below-the-line expenses include the following:

**Account 426.1 Donations:** Payments or donations for charitable, social or community welfare purposes.

**Account 426.3 Penalties:** Includes payment by the company for penalties or fines for violation of any regulatory statutes by the company or its officials.

**Account 426.4 Expenditures for certain civic, political and related activities:** Expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation or ordinances or approval, modification, or revocation of franchises; or for the purpose of influencing the decisions of public officials, but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations.

**Account 426.5 Other Deductions:** Includes other miscellaneous expenses which are . . . properly deductible before determining total income before interest charges.

DESC conducts training and periodically sends instructional communications to personnel who enter and approve costs into its accounting systems with particular emphasis on which costs need to be accounted for below-the-line and which do not. Specifically, the training and instructional communications direct personnel to book non-allowable expenses below the line in **Account 426.5 Other Deductions** if they are not properly recorded in any of the other below the line accounts. The Company maintains an expense reimbursement and procurement card policy that must be followed by all employees. It specifically addresses the categorization of expenses into above the line and below the line costs. In updating its instructional materials and training, DESC periodically evaluates the items that the Commission has disallowed in past orders or that ORS has challenged. The Company's expense reimbursement and procurement card policy and instructional materials reflect the positions DESC has agreed to accept in compromise or settlement or not to challenge in past proceedings. However, these are not positions the Company agrees with as a matter of ratemaking policy and reserves the right to challenge them here.

It should be emphasized that because of the human factors involved, no system of internal accounting controls is perfect. DESC's record-keeping involves thousands of employees who manage over four million transactions per year in the general ledger. DESC takes reasonable steps to ensure that the recording of costs is consistent with regulatory policy and below-the-line expenses are not recorded above-the-line. In addition, DESC tests its accounting systems and controls to ensure that such controls do not include any material weaknesses. Those tests consistently indicate no material weaknesses are present. To the extent individual transactions are not recorded appropriately above- or below-the-line, it is a matter of inadvertence that occurs at a very low frequency. In past rate proceedings and Rate Stabilization Act audits, the dollar value and volume of mischaracterized transactions were extremely small compared to the total volume of transactions.

### 3. POLICY ISSUES

Based on past experience in this area, and in addition to the issues raised by others, DESC respectfully requests the Commission review the following policies as they relate to allowable and non-allowable expenses. Certain key areas of disagreement related to disallowances are listed below.

#### **A. Costs Associated with Safety Awards, Employee Service Recognitions, Spot Bonuses and Awards**

It is axiomatic that the safety and quality of service provided by a utility depend on the skills, motivation and customer focus of its employees. It is also true that employee turnover results in additional cost to the utility, the loss of highly valuable skills and the loss of the utility's investment in training those skills. In the utility industry and in businesses generally, firms invest in programs that recognize employees for extraordinary commitment to safety and customer service, for longevity in service, for major accomplishments in achieving corporate goals and for living out corporate values. They do so because this investment has a positive effect on the retention of skilled employees and the strengthening of a safety and customer service culture and general morale. That positive effect goes far beyond the cost of the events and awards provided.

Organizations of the size and scope of a utility need organized processes and programs for acknowledging and rewarding accomplishments. Given the universal acceptance of awards and recognition programs as part of routine utility and business operations and given the importance of skilled employees and a culture committed to safety and customer service, it is entirely appropriate to recognize that such programs are a valid cost of providing utility service.

In allowing such costs to be recognized for rate-making purposes, it is also appropriate that there be guidelines for ensuring the reasonableness of the scope, terms and costs of the programs involved. DESC recommends that the Commission issue regulations under which utilities are encouraged to adopt written policies that define the permissible scope, basis, terms and costs for service and safety recognitions, service awards, retirement receptions, spot bonuses and similar employee recognition programs. ORS should be permitted to review and comment on such policies as they are formulated to ensure that they are reasonable. ORS should then review the implementation of those policies in each rate proceeding to ensure that they are being appropriately applied. If the resulting policies are reasonable in scope and cost, and if the policies are being reasonably applied, then the resulting costs should be recoverable. If not, then ORS should be required to put testimony in the record identifying specific expenses and establishing that they are unnecessary or excessive. Such a showing is clearly necessary under the legal standards cited above.



**B. Costs Associated with Meals and Food Provided for Training, Planning and Other Business Purposes**

At times when training, planning or other meetings take place, it is more efficient for the Company to provide lunch for participants rather than adjourning the meeting while participants travel to a restaurant, eat and return. In such circumstances, the value of the meal is more than offset by the value of the time that would otherwise be lost. This is particularly true where personnel travel from across the service area to meet for training or other valid corporate functions.

ORS has objected to the recoverability of the cost of meals and other food and refreshments provided to employees during training and planning sessions and other business related meetings. DESC would respectfully request the Commission rule that meals and other food provided to employees in furtherance of valid training programs, planning or other business meetings are a valid cost of utility operations. For oversight purposes, it would be entirely appropriate for the Commission to issue regulations requiring written policies concerning these expenses to be adopted with review and comment by ORS. In each rate proceeding, ORS should then audit the implementation of those policies to ensure that utility's costs comply with them. However, DESC would respectfully submit that it is not enough, under the *Hamm* and *Daufuskie* cases cited above, for ORS simply to conclude that all such expenses are ineligible for recovery, without pointing to an evidentiary basis raising the reasonable likelihood of imprudence as to any particular expense.

**C. Documentation Issues**

In recent audits, ORS has taken the position that certain expenses associated with training and business meetings cannot be recovered unless a list of attendees is provided. As an example, in the storm damage context, ORS has disallowed the costs of food and beverages because the Company did not maintain lists of all those employees to whom these items were distributed or made available.

DESC believes that ORS's position on these matters is not reasonable and does not constitute a lawful basis for disallowance of the costs in question under the *Hamm* and *Daufuskie* cases cited above. The nature, amount and business justification of the costs involved can be sufficiently demonstrated through means other than those ORS has been willing to recognize. As a general matter, such expenses are documented by reimbursement and procurement card reports submitted by the employees involved showing the nature, amount and business purpose of the expense. These statements are reviewed and approved by the employee's manager or supervisor. Those employees are subject to discipline up to and including termination if their reimbursement reports are fraudulent. ORS can review those statements and conduct additional investigation if matters are unclear.

DESC respectfully requests that the Commission issue a policy, preferably by regulation, establishing that where documentation is reasonably sufficient in the ordinary course of business to establish the fact, nature and the amount of an expense, that expenses should not to be disallowed

due to documentation concerns. This is another instance where it would be appropriate for the Commission to specify that each utility should adopt a written policy, preferably formulated with review and comment by ORS, and that so long as such policy is reasonable and costs are documented according to its terms, those costs are not to be disallowed.

#### **D. Coffee, Kitchen Supplies and Related Items**

Like many employers, DESC may provide its employees with coffee, tea, cups, kitchen supplies and related items (sugar, low-calorie sweeteners and creamer) at various locations throughout its offices. Costs of this nature are routinely accepted as reasonable business expenses in the utility industry and in business generally. They avoid the need for employees to go off site for coffee breaks or refreshment and promote efficiency and commitment to the work at hand, which at times requires employees to work well beyond normal business hours.

These expenses have been questioned in recent audits. ORS has recently allowed the recovery of certain of these expenses for operational locations but not for administrative locations and has denied recovery of kitchen supply expenses for all locations. DESC respectfully requests the Commission rule that so long as the costs in question are reasonable and not excessive, they should not be disallowed. Again, a policy on this matter, formulated with ORS review and comments, could be advisable.

#### **E. Other Expenses**

There are a number of other expenses which are currently treated as automatically non-allowable that could warrant reconsideration in light of appropriate policies and controls. Simply issuing a policy that makes certain categories of expenses non-allowable in all circumstances does not permit consideration of the circumstances when such expenses can be reasonable costs of operating a utility system. Defining those circumstances by policy is preferable to categorical exclusion and is more consistent with the legal principles referenced above.

### **4. A REGULATION IN RESPONSE TO THESE MATTERS**

DESC would respectfully request the Commission issue a regulation embodying the provisions suggested above and, in addition, establish a process for Commission review of disputed disallowances. In many cases, the amounts in question are relatively small and absent a means to effectively raise disputes about them before the Commission, these would be matters that will never be heard and decided in a constructive manner. DESC would suggest a regulation allowing challenges to expenses be heard expeditiously on a paper record, with ORS and the Company filing written statements of position along with the source documents and affidavits. No hearing would be required. The regulations should specifically state that the issues would be taken up as expeditiously as possible.

## 5. CONCLUSION

DESC believes that this is an opportune time for the Commission to create additional clarity and certainty around disallowance issues. DESC recommends that the centerpiece of the approach be Company-specific policies created through a collaborative and transparent process involving ORS. The Company submits that a blanket policy disallowing specific categories of expenses does not constitute a lawful basis for disallowance under the *Hamm* and *Daufuskie* cases cited above. DESC would respectfully request the Commission give serious consideration to this and the proposals made here.

Thank you for your consideration of these matters.

Respectfully submitted,

/s/Belton T. Zeigler

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